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now proposes to adopt an April 30 deadline. The rule, as amended, is necessary and reasonable and the amendment proposed does not constitute a substantial change for purposes of Minn. Rule 1400.1100 (1985).

9553.0041, subp. 8, item B.

113. Under this item the Commissioner is authorized to reject incomplete and inaccurate reports and require a facility to provide any additional information necessary to support the payment rate requested in the cost report. If the corrected report or the additional information requested is not filed within 20 days of the request the report must be rejected. The rule provides that the Commissioner "may" extend the 20-day time period if the facility makes a showing of good cause in writing and the Commissioner determines that the delay will not prevent him from establishing a timely payment rate. It is necessary and reasonable to authorize the Commissioner to reject inaccurate or incomplete cost reports or to make requests for additional information necessary to support the payment rate. The 20-day time period required for compliance is also necessary and reasonable since extensions can be obtained upon a showing of good cause. However, the language governing the approval of extensions violates the provisions of Minn. Stat. § 14.05, subd. 1, because it gives the Commissioner unfettered discretion in granting or refusing to grant extensions meeting the criteria set forth in the rule. This constitutes a substantive violation of law for purposes of Minn. Stat. § 14.50 (1984). To correct this defect, the sentence beginning on page 34, line 32 and ending on line 36 must be amended to read as follows:

Upon a showing of good cause in writing the commissioner shall extend the 20-day deadline if the delay requested by the facility will not prevent the establishment of timely rates.

114. Item B also provides that the failure to file the required cost report and the failure to correct the form of an incomplete or inaccurate report shall result in its rejections and in a reduction of the payment rate as specified in subpart 10 (discussed below). For a facility's failure to provide additional information necessary to support the payment rate request, the providers' rates must also be reduced as specified in subpart 10, unless the total payment rate can be calculated by the disallowance of the cost for which the information was requested, in which case no reduction under subpart 10 may occur. Except as noted below, these are necessary and reasonable requirements to ensure that the Department is reimbursing providers at an appropriate level. However, it is recommended that the Department reconsider its use of the word "additional". Apparently the "additional" information the Department has in mind in item B is the "supplemental" information listed in subpart 3, as the latter rule would cover any other information request. If that is the case, the word "supplemental" should be used, and the words "necessary to support the payment rate request" (pg. 34, lines 28-29) could be deleted and replaced with a reference to subpart 3.

The imposition of sanctions was not shown to be necessary and reasonable when a provider is unable to get the information required under subpart 2, item I and subpart 3, item C. If the lease was executed before the date these provisions were first adopted, a provider will be unable to provide the information if the lessor refuses to make it available. Even if the facility included a

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clause in its contract which would obligate the lessor to provide the data required under the rule, the lessor may refuse to abide by its obligations or delay performance. In such cases, the provider would be unable to comply. Imposing sanctions on the provider in such a situation was not shown to be necessary and reasonable, contrary to the requirements in Minn. Stat. § 14.14, subd. 2. To correct this defect, an exception to item B must be added to the rule to cover these situations.

9553.0041, subp. 8, item C.

115. This item originally authorized a one-month extension of the deadline for filing the annual cost report. The Department now proposes to delete it from the rules because it has amended item A to permit the filing of cost reports one month later than originally proposed. The deletion is necessary and reasonable and does not constitute a substantial change for purposes of Minn. Rule 1400.1100 (1985). However, it is suggested that the Commissioner retain a provision for approving extensions of the new reporting deadline. Unexpected illnesses, deaths and catastrophes can always occur, and a provision recognizing those events as grounds for an extension should be adopted.

9553.0041, subp. 9, Effective Date of Total Payment Rate.

116. Under this subpart the Commissioner is required to notify each facility of its total payment rate by September 1 each year. That rate is effective the first day of the following month. Several individuals commented that this section should require that penalties be imposed on the Department in the event that rates are not set by September 1, but the nature of the penalties they have in mind is unclear. When rates are not set in a timely manner the facilities are subjected to many hardships. They can never be certain whether the costs claimed will be allowed and they are unable to rely on the payment rate requested. This makes it impossible to adopt a reliable budget and may cause them to spend monies the Department may later refuse to reimburse. This causes shortages in the future. Admittedly this is a serious problem. However, the rule proposed is necessary and reasonable. The Administrative Law Judge is not authorized to require the Department to impose sanctions upon itself, to pay fines to facilities or to recognize costs that are not allowable simply because the determination is not made by a specified date. The only recourse available to facilities in this situation would be in the Legislature, in a contested case or in the Courts.

9553.0041, subp. 10, Noncompliance.

117. This rule provides that a facility's total payment rate will be reduced by 20% if it fails to file the reports, documentation and worksheets required in part 9553.0041. The reduction is effective 21 days after a written request for "additional information", except when an extension is granted. For the failure to provide required cost report information in subparts 1 or 2, or the failure to certify reports pursuant to subpart 7, the reduction occurs on April 30 or 21 days after the Commissioner's written request for correction or completion, unless an extension is granted. These provisions are necessary and reasonable as proposed. If the Commissioner does not have the information necessary to calculate a reliable rate, some mechanism must exist for determining how much a facility will be paid until a reliable rate can be calculated. The Commissioner has determined that he

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should pay facilities 80% of their current rate under these circumstances. That is a necessary and reasonable figure. In establishing the percentage reduction that is appropriate, a variety of possible percentage figures could be reasonably chosen. The figure the Commissioner has chosen is within a reasonable range, as it is equivalent to the percentage reduction permitted by statute when nursing homes are involved in similar circumstances.

9553.0041, subp. 10, item C.

118. Under this item, a facility whose rate has been reduced for its failure to file accurate and complete costs reports or to provide additional information needed to establish a payment rate is not entitled to obtain retroactive reimbursement when the defects resulting in the reduction of its payment rate have been corrected. This provision is unauthorized and outside the scope of the Commissioner's delegated rulemaking authority. As such it violates Minn. Stat. § 14.05, subd. 1, and constitutes a substantive violation of law for purposes of Minn. Stat. § 14.50 (1984). The Department argues that requirements without sanctions are meaningless. However there is a sanction in the rule. That sanction is an 20% reduction in rates and a reduction in monies ICF/MRs may need to finance ongoing expenditures. That, itself, is a penalty. Since Minn. Stat. § 256B.501, subd. 3, requires that ICF/MRs be reimbursed for the costs that must be incurred, it is concluded that the Department is not authorized to refuse retroactive reimbursement covering such costs in the absence of a specific delegation of authority to do so. Therefore, to correct this defect, item C must be amended to permit retroactive recovery.

9553.0041, subp. 11, Audits.

119. This subpart governs Departmental audits of all facilities. It generally requires the Department to perform desk and field audits of all cost reports and supporting documentation to determine that each facility has complied with the rules, and permits retroactive adjustments to be made based on the audit findings. If the audits reveal any inadequacies in a facility's record keeping or accounting practices, the Commissioner is authorized to require the facility to engage competent, professional assistance to correct those inadequacies so that the field audit may proceed. These are necessary and reasonable provisions and may be adopted.

120. Item B of this subpart states that field audits may cover the four most recent annual cost reports for which desk audits have been completed and payment rates have been established. Mr. Furlong strenuously objected to this language and argued that it should be changed to permit field audits only for the four most recent annual cost reports. In his view this language would permit the Department to perform a field audit within four years of the time a "final rate" is established. He noted that once an appeal is filed no final rate exists until the appeal is resolved, and that many providers now have appeals pending, some dating back as far back as 1978, which means that field audits could go back that far in time. He argued that the number of appeals will increase under these rules, and final rates will be further delayed, permitting the Department to audit cost reports well outside the 4-year period. He also noted that the disallowance of a cost has a cumulative effect and generates paybacks in each subsequent year. However, the rule does not mention "final" rates. On the contrary, once a rate is fixed, the time period starts running. The filing of an appeal has no effect. Moreover, the

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Department does not intend to apply the rule in the manner suggested by Mr. Furlong. In its post-hearing response to similar comments made by Mr. Lanigan, it noted that only rates for the four reporting years under audit may be adjusted under subpart 13, item G, and that if errors or adjustments are found in cost reports pertaining to periods outside the four-year audit period, the effect of those adjustments will result in changes to rates only during the four-year audit period. Thus, cost reports from prior periods can be examined and field audited, but adjustments can only be made in the four most recent cost reports. Therefore, it is concluded that this item is necessary and reasonable and may be adopted.

9553.0041, subp. 16, Reporting Real Estate Taxes, Special Assessments and Insurance.

121. In its post-hearing comments, the Department has proposed a new subpart 16. Apart from its title, it will read as follows:

The facility shall submit a copy of its statement of real estate taxes payable for the calendar year in which the rate year begins and a copy of the invoices for the real estate insurance and professional liability insurance for coverage during the rate year by June 30 each year. Except as provided in this subpart, the Commissioner shall disallow the costs of real estate taxes, special assessments, real estate insurance, and professional liability insurance, if the documentation is not submitted by July 31. The disallowance shall remain in effect until the facility provides the documentation and amends the cost report under subpart 14. The historical operating cost for the special operating costs during the reporting year must be shown on the cost report.

The new language proposed in this subpart is necessary and reasonable in order to recognize costs over which the facility has no control and which are escalating faster than changes in the Consumer Price Index. The language does not constitute a substantial change for purposes of Minn. Rule 1400.1100. On the contrary, the special operating cost category created by the Department was established at the request of industry commentators and after full discussion.

DETERMINATION OF TOTAL OPERATING COST PAYMENT RATE

122. Part 9553.0050 governs the calculation of the total operating cost payment rate. As originally proposed, it required a separate calculation of the allowable historical operating cost per diem for the program, maintenance and administrative cost categories. The separate per diems were adjusted for changes in the consumer price index and added together. The efficiency incentive, if any, a facility was entitled to receive was added to the sum of the per diems. The resulting figure constituted the facilities' total operating cost payment rate. These methodologies, as discussed below, have been modified in response to public comments. The modifications change the limitations on allowable historical administrative operating costs, add new provisions for the reimbursement of audit costs, and add provisions for the inclusion of special operating costs in the operating cost payment rate.

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9553.0050, subp. 1, Establishment of Allowable Historical Operating Costs Per Diem.

123. Under Minn. Stat. § 256B.501, subd. 3(b) the Commissioner is required to include limits on the amounts of reimbursement for property, general and administration, and new facilities. In addition, the LAC Report recommended that the Department adopt caps on specific cost categories -- especially administrative costs. To implement the statute, the Department originally proposed to limit administrative costs to a fixed percentage of the total of all other operating cost categories. That proposal, contained in subitem (1), was soundly criticized by industry speakers. In response to those criticisms, the Department proposes to amend subitem (1) to read as follows:

- (1) For the rate years beginning on or after October 1, 1986, the administrative allowable historical operating costs shall be limited as in units (a) to (g).
 - (a) The commissioner shall classify each facility into one of two groups based on the number of licensed beds reported on the facility's cost report. Group one shall include those facilities with more than 20 licensed beds. Group two shall include those facilities with 20 or fewer licensed beds.
 - (b) The commissioner shall determine the administrative allowable historical operating cost per licensed bed for each facility within the two groups in unit (a) by dividing the administrative allowable historical operating cost in each facility by the number of licensed beds in each facility.
 - (c) The commissioner shall establish the administrative cost per licensed bed limit by multiplying the median of the array for each group of administrative allowable historical operating costs per licensed bed by 105 percent.
 - (d) For the rate year beginning October 1, 1986, the cost of a certified audit must not be included in the computation of the administrative allowable historical operating cost or its limit. The facility shall report to the commissioner by July 31, 1986, the greater of the cost incurred for a certified audit for either the reporting year ended December 31, 1985 or a fiscal year ending during the 1985 calendar year.

The commissioner shall determine the average cost of a certified audit per licensed bed by totaling the cost of each certified audit submitted to the commissioner by July 31, 1986, and dividing the sum by the total number of licensed beds in facilities which have submitted costs for a certified audit. The maximum allowable cost for a

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certified audit shall be the lesser of the facility's reported cost or 115 percent of the average cost of a certified audit per licensed bed multiplied by the number of licensed beds in the facility.

(e) For the rate years beginning on October 1, 1986 and October 1 1987, the maximum administrative allowable historical operating cost shall be the lesser of the facility's administrative allowable historical operating cost or the amount in unit (c) multiplied by the facility's licensed beds.

(f) For rate years beginning on or after October 1, 1988, the commissioner shall increase the administrative cost per licensed bed limit in unit (e) by multiplying the limit established for the rate year beginning October 1, 1987 by the percentage change in the all urban consumer price index (CPI-U) for Minneapolis-St. Paul as published by the Bureau of Labor Statistics, United States Department of Labor, between the two most recent Januarys prior to the beginning of the rate year. The year 1967 is the standard reference base period. The maximum administrative allowable historical operating cost shall be the lesser of the facility's administrative allowable historical operating cost or the amount determined in this unit multiplied by the facility's licensed beds. The commissioner may recompute the limit in this unit once within a five-year period.

(g) The administrative cost per licensed bed limit and the average cost of a certified audit determined in this subitem must not be adjusted as a result of field audits, appeals, and amendments.

Under the proposed amendment, ICF/MRs are divided into two groups: those having 21 or more licensed beds and those having 20 or fewer. The historical allowable administrative costs per licensed bed (exclusive of certified audit costs) are then calculated for each facility. One hundred and five percent of the median cost per licensed bed is then calculated for each group. For rate years beginning on October 1, 1986 and October 1, 1987 each facility's maximum allowable historical operating cost is limited to the lesser of its actual historical operating cost per licensed bed or 105% of the median multiplied by the number of its licensed beds. For rate years beginning on or after October 1, 1988 the administrative cost per licensed bed limit is increased by the percentage change in the urban consumer price index for the Minneapolis-St. Paul area.

Under the amendment, the cost of obtaining a certified audit is not included in the computation of the administrative allowable historical operating cost, or the limitation, for the rate year beginning on October 1, 1986. For that rate year, the cost of obtaining a certified audit is separately calculated and separately limited. The rule requires facilities to report their certified audit cost to the Commissioner, who then must calculate

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the average cost of a certified audit per licensed bed. The maximum allowable cost for a certified audit is the lesser of a facility's reported cost or 115% of the average cost of per licensed bed multiplied by the number of licensed beds in the facility.

124. In a recent study of 289 cost reports, the Department found that administrative costs, as a percentage of total costs, generally decrease as the size of a facility increases, and that there was a natural gap at the 20-bed level (SNR, p. 45). Moreover, percentages varied over a smaller range for facilities with more than 20 beds. Based on those differences, it is concluded that the grouping of facilities on the basis of a 20-bed cutoff is necessary and reasonable. The Department chose to use an adjusted median figure because half of all providers would be below it, the assumption being that if half of all providers can operate below the median the other half, if efficiently operated, should be able to do so too. That is a reasonable assumption to the extent that the providers in the respective groups are similarly situated. However, there are variables in the size, costs and type of residents facilities have. The Department has addressed those variables in several ways. Costs that are unique to some providers have been separately reimbursed; size factors have been equalized by the groupings proposed; and a 5% margin has been added to the median figure. Other variables, such as the type of resident served are addressed, if at all, in the 5% adjustment. That is reasonable since the type of resident served was not shown to be a factor affecting administrative costs and in view of the other changes required in this Report, it is concluded that 105% limitation in the proposed amendment is necessary and reasonable.

The Department stated that the "extra 5%" increases the probability that a provider over the median will not have to revise its spending in the administrative cost category (Post-hearing Comment, p. 38). However it may wish to reconsider that 5% factor. The Legislature has favored using the 60th percentile in similar situations. See, Minn. Stat. § 256B.431, subd. 2a (1984). Moreover, the 1984 data the Department used to group facilities shows a wide disparity in administrative cost percentages for smaller facilities. This suggests that many of them may be unable to come within the 105% limitation.

125. Ms. Martin argued that the amendments to subitem (1) are inappropriate because they will permit or require administrative cost increases exceeding cost increases in other areas of the economy. That argument is not persuasive. Minn. Stat. § 256B.501, subd. 3, limits operating cost increases to those which do not exceed increases in other section of the economy. The Department has implemented that provision in subitem (2). The costs allowable under subitem (2) are those which will be used to calculate the median. Even if that was not the case, the Administrative Law Judge is not persuaded that the statute precludes administrative cost increases that are incurred to comply with the Department's rules, such as obtaining audits and additional cost reports. Similarly, recognition of large increases in insurance premiums, if unique to ICF/MRs, is permitted in spite of the limitation. The statute has to be given a practical construction.

126. It was argued that certified audit costs should not be included in the administrative cost category after the 1986 rate year because only those providers having 48 or more licensed beds are required to obtain certified audits, and Group Two includes all providers with more than 20 beds. Since

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some providers in Group Two are not required to obtain audits, the argument is that the median will be skewed downward and the larger providers will be prejudiced. However, the reverse is also true: providers with less than 48 beds are required to submit balance sheets and income statements. They will be prejudiced if the costs of preparing those documents by larger facilities (part of the audit documents) are not included in the administrative cost category. While the impact in the latter case will be smaller, some prejudice will occur.

The Department excluded certified audit costs from the median in the first year because audit costs may not be in the cost base and the cost of a first-time audit may be substantial. It included them in the second year because they will be in the cost base and audit costs should decrease. By including them in the median the second year, the Department has, in effect, determined that audit costs are the result of a provider's decision to be a large, complex operation. It can be argued, however, that audit costs mandated by the Department should be reimbursed because they are a cost over which the larger provider has little control. Moreover, when those costs are included in the operating cost category, the median calculated on the basis of those costs does not accurately reflect how cost-effective the provider's audit costs are because some providers do not have those costs. While the arguments for excluding certified audit costs from the median in every year appear more reasonable, the Department's approach is a reasonable alternative. It may consider certified audit costs as an aspect of a larger facility's overall efficiency. Therefore, it is concluded that unit (d) is necessary and reasonable.

127. However, the last sentence of unit (f) is unauthorized. It permits the Commissioner to amend the rule without complying with the provisions of the Administrative Procedure Act, contrary to Minn. Stat. § 14.05, subd. 1 (1984). A percentage figure may be changed without compliance with the APA only where the rule contains a specific methodology for calculating the percentage. This rule contains no such criteria. This constitutes a substantive violation of law for purposes of Minn. Stat. § 14.50. To correct this defect that sentence must not be adopted.

Apart from the foregoing it is concluded that the amendment to 9553.0050, subpart 1, item A, subitem (1) is necessary and reasonable and may be adopted. Although it establishes a different system for calculating the mandatory limit on administrative costs, the amendment was a logical outgrowth of the hearing process and was designed to address public criticism of the rule originally proposed. It does not affect classes of persons not represented at the hearing, go to a new subject matter of significant substantive effect, or make a substantial change not raised by the original hearing notice. Therefore, it is concluded that it is not a substantial change for purposes of Minn. Rule 1400.1100 (1985).

9553.0050, subp. 1, item A(2).

128. This subitem contains a second limitation on allowable historical operating costs for rate years commencing on or after October 1, 1986. It provides that allowable historical operating costs in the maintenance and administrative cost categories cannot exceed the payment rate for each of those cost categories during the reporting year. The limitation is calculated by multiplying the operating cost payment rate in effect during the reporting year by the applicable resident day figure. The rule is designed to prohibit a facility's costs from increasing at a faster rate than cost increases

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incurring in other sectors of the economy. For example, a facility that has a \$10 rate will not be permitted to incur \$12 in costs. Instead, it will be limited to the \$10 figure during the reporting year. Since the \$10 figure already reflects changes in the CIP-U, this is a reasonable approach and is consistent with legislative directive.

129. Georgine Busch, an ARRM Advisory Committee Member, argued that a limitation on maintenance costs is unreasonable. She argued that food costs cannot be kept to historical levels plus increases in the consumer price index. She suggested that facilities be given leeway to spend up to 10% more than their historical costs. In spite of these objections, the Administrative Law Judge is persuaded that the rule proposed is necessary and reasonable. Under Minn. Stat. § 256B.501, subd. 3(a), the Department is generally required to limit operating cost increases to a level which does not exceed those in other areas of the economy. It was also argued that limiting a facility's historical costs to the amount permitted under its historical rate is not appropriate for the administrative cost category because the Department is requiring additional administrative duties not reflected in past rates. Commentators mentioned, for example, the second cost report required in 1985, the costs incidental to changing reporting years -- such as changing fiscal years -- and the additional consulting costs involved in complying with the rule. It was argued that these factors will necessarily increase administrative costs and that such increases should be recognized and allowed. The uniform reporting year required by these rules will require most facilities to change fiscal years and to make adjustments in their accounting practices. This will involve increased costs, especially in 1986. Likewise, requiring a uniform reporting year will increase costs for some providers because it will shorten the time period between cost reports. For example, a facility that currently has a fiscal year ending in November, 1985 will be required to file a cost report for the fiscal year ending that month. Its next cost report will not be for the fiscal year ending November, 1986, but will be for the calendar year ending December 31, 1985. In other words, it will be filing its subsequent cost report eleven months sooner than in the past. On the other hand, in 1986, its cost report will be for the calendar year ending in December, rather than a fiscal year ending in November -- a one month delay. Therefore, because of the change to a uniform reporting year, the 73 facilities whose 1985 cost reports were for fiscal years ending in July through November 1985 are at the greatest risk of exceeding their historical administrative rate because a second cost report is due for the calendar year 1985. Other facilities will not be in jeopardy. For example, a facility that filed a cost report for the fiscal year ending in January, 1985 will have to file its next cost report one month sooner than normal -- for the calendar year ending December 31, 1985. However, its next cost report is not for the fiscal year ending in January 1986, but the calendar year ending in December 1986 -- a delay of 11 months.

Recognizing that the Department's rules do not have to reimburse all costs with mathematical precision, it is concluded that the limitation in subitem (2) is necessary and reasonable. However, it is suggested that the Department except administrative cost increases relating to the services of accountants incurred in 1986 from the limitation in this part to the extent that they exceed that otherwise permitted in a facility's rates, as it did for audit

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costs. That need only be a one-time exception and would not be made a part of the facility's historical costs in 1986. The additional costs facilities must incur to comply with these rules were not the kinds of costs the Legislature intended to limit. Compliance has a price that should be reimbursed.

130. In response to public comments the Department has proposed to delete program operating costs from the limitations of this subitem. It has determined that program costs should be excluded to enable facilities to increase historical program expenditures as resident needs change. An amendment to permit increased program costs for those purposes is necessary and reasonable and is not a substantial change for purposes of Minn. Rule 1400.1100.

The second paragraph of subitem (2) requires that a program, maintenance and administrative operating cost payment rate be calculated for the reporting years preceding the rate years beginning October 1, 1986 and October 1, 1987. This adjustment and those specified in units (a) to (c) of subitem (2) are necessary for reporting years prior to October 1, 1987 because rates paid during those reporting years are not separately identified as a function of the individual cost categories. In its post-hearing comments, Department proposed to amend the second paragraph of subitem (2) to read as follows:

For the rate year beginning October 1, 1986, and October 1, 1987, the facility's total operating cost payment rate in effect during the reporting year must be adjusted for reclassifications in accordance with part 9553.0041 and separated into program, maintenance, and administrative operating cost payment rates according to units (a) to (c).

As amended, subitem (2) is necessary and reasonable. It clarifies the fact that the operating cost payment rate must be adjusted in accordance with the provisions of this rule. The amendment proposed is not substantial for purposes of Minn. Rule 1400.1100 (1985).

131. Richard V. Stewert argued that the basis for determining the cap under subitem (2) is unfair because the base will not include central office costs. As the Administrative Law Judge understands this provision, however, a facility may go back and recompute its base using the new classifications in the rule. If that is not the Department's intent, it should clarify the reporting year adjustments that are permissible. If some other result is intended, the reasonableness of this subitem must be redetermined when the final rule is submitted to the Chief Administrative Law Judge.

9553.0050, subp. 1, item A.(3)

132. This subitem originally authorized facilities to exceed the allowable historical program operating cost limit in cases where the facilities' maintenance and administrative costs were below the limits originally proposed in subitem (2). Since the Department has removed the limitations on program costs originally contained in subitem (2), this subitem is no longer necessary and the Department's amendment to delete it is appropriate. The deletion does not constitute a substantial change for purposes of Minn. Rule 1400.1100 (1985).

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